

July 11, 2000

The Honorable Christopher S. Bond, Jr.  
Chairman  
Committee on Small Business  
United States Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

We are writing to express the strong opposition of the Department of the Treasury and the Internal Revenue Service to S. 1156, the "Small Business Advocacy Review Panel Technical Amendments Act of 1999," the provisions of which have been added to H.R. 3843, the "Small Business Reauthorization Act of 2000." The Department of the Treasury and the IRS strongly oppose the inclusion of these provisions within H.R. 3843 and urge that they be deleted from the bill.

IRS Actions to Address Small Business Concerns

Both the IRS and the Department of the Treasury are committed to working closely with the small business community and its representatives to help small businesses and the self-employed understand their tax obligations and reduce their compliance burdens. Many of our short- and long-term initiatives to help small businesses and the self-employed were discussed by Commissioner Rossotti in testimony before the Committee on Small Business last month.

The newly restructured IRS is being built around four organizational units with end-to-end responsibility for serving specific groups of taxpayers. One of these units is the Small Business and Self-Employed Operating (SB/SE) Division, which will serve the approximately 7 million taxpayers that are small businesses. Because the IRS recognizes that these taxpayers often face complicated tax issues, but may lack the financial resources to understand and address these issues, one of the primary focuses of the SB/SE Division is to work with small businesses to teach them about their federal tax responsibilities and to work with them to develop less burdensome and more practical means of compliance. The SB/SE Division will also assume an important role in reviewing IRS regulations to ensure that they minimize burdens placed on small businesses consistent with the requirements of the tax law and principles of sound tax administration. We also are open to working with small business interests to enhance their participation in IRS' rulemaking process.

The IRS also is expanding the ways it communicates with small businesses. For example, in 1999 the IRS initiated "The Small Business Corner" on the IRS Internet site. It provides small business taxpayers with easy-to-access and easy-to-understand information necessary to comply

with their federal tax responsibilities. The IRS expects that this type of convenient "one-stop shopping" eventually will provide virtually all of the products and services that a small business needs.

In conjunction with the Small Business Administration, the IRS last year produced a CD-ROM, "Small Business Resource Guide: What You Need to Know About Taxes and Other Topics." The CD-ROM is an interactive multi-agency product utilizing the latest technology to provide the small business taxpayer with easy-to-access and easy-to-understand information. Not only does it provide a broad range of useful information for the small business community -- from pre-startup to closing or selling a business -- but it also includes all of the business tax forms, publications and instructions for *e-filing*. The CD-ROM also allows users with Internet access to link to other helpful federal and state web sites. Because the 1999 CD-ROM received very favorable reviews from small businesses, a year 2000 updated version of the CD-ROM is being made available free of charge by phone or through the IRS Web site.

The IRS also hosted the "1999 Business and Professional Roundtable: Tax Forms Forum." At this forum, small business trade associations and tax practitioner organizations discussed their concerns about tax form complexity with IRS executives. A second forum is scheduled for June 26, 2000.

In addition, the IRS has made two important changes designed to improve tax administration and reduce compliance burdens for small businesses. As of January 1, 2000, taxpayers are no longer required to use the Electronic Federal Tax Payment System (EFTPS) unless they have annual tax deposits greater than \$200,000. Previously, taxpayers were required to use EFTPS if they had annual tax deposits greater than \$50,000. As a result of this change, approximately 65 percent of the taxpayers that were required to use EFTPS are no longer required to do so.

In 1998, the IRS doubled (from \$500 to \$1,000) the exemption from the employment tax deposit requirements. Because of this change, more than 25 percent of all small business employers may pay employment taxes with their quarterly returns rather than depositing them several times during the quarter.

#### S. 1156 Would Harm Efficient Tax Administration

S. 1156 would amend section 609(d) of the Regulatory Flexibility Act (RFA) to include the IRS within the limited group of agencies required to engage in a review panel process before they can issue a proposed rule for which an initial regulatory flexibility analysis is required. However, this change is not necessary to ensure that small business concerns are heard during the regulatory process and it would interfere substantially with key imperatives of tax administration.

We are extremely concerned that the review panel process will result in a select group of taxpayers having advance knowledge of regulatory provisions that often could result in a competitive advantage relative to other taxpayers. The premature disclosure of regulatory provisions is extremely sensitive in the tax area because it often could allow those with advance

knowledge to structure transactions to avoid effective dates or otherwise frustrate the intent of a regulation. Moreover, in some circumstances, even the mere knowledge that a particular tax rule is about to be issued is sufficient to provide an advantage over those without this knowledge. Such a result would be fundamentally unfair to other taxpayers and would erode public confidence in the integrity of tax administration.

A fundamental tenet of efficient tax administration is the need for adequate guidance. The most frequent criticism of IRS rulemaking is that the IRS needs to provide taxpayers with more guidance and provide that guidance faster. Subjecting IRS rules to the review panel process will make it impossible for the IRS to quickly provide needed regulatory guidance to taxpayers in many cases. By diverting resources to comply with the review panel process, the bill will reduce the total amount of guidance the IRS is able to issue for the benefit of all taxpayers, including small businesses.

#### IRS Rules That Effect Small Businesses Already Are Subject to Added Scrutiny

There are currently a number of statutory requirements that subject IRS regulations to added scrutiny. First, pursuant to section 7805(f) of the Internal Revenue Code (26 U.S.C. 7805(f)), every IRS proposed rule is required to be sent to the Chief Counsel for Advocacy in the Small Business Administration for review and comment. The IRS is then required to consider all comments submitted by the Chief Counsel and to address those comments in the preamble to the final rule. To our knowledge, no other agency is required to submit all of its proposed rules to the Chief Counsel for review.

Second, RFA section 603 currently makes the RFA applicable to IRS proposed and final interpretative regulations to the extent that they impose reporting or recordkeeping requirements on small businesses. Section 603 was amended in 1996 as part of the Small Business Regulatory Enforcement and Fairness Act (SBREFA) to address the specific concerns expressed by small businesses about paperwork burdens associated with IRS regulations. S. 1156, however, would further amend section 603 to make all IRS proposed, final and temporary interpretative rules subject to the RFA without regard to whether they impose reporting or recordkeeping requirements on small businesses.

This amendment is objectionable for two reasons. First, the 1996 SBREFA amendment struck the appropriate balance between the concerns expressed by small businesses over paperwork burdens in IRS regulations and the recognition that IRS interpretative temporary rules provide taxpayers with guidance on how to comply with the provisions of the tax code. This continues to be the appropriate principle for the applicability of the RFA to interpretative tax regulations.

Second, subjecting IRS temporary rules to the requirements of the RFA is fundamentally inconsistent with the informal rulemaking provisions of the Administrative Procedure Act (APA) (5 U.S.C. 553) and would represent a significant departure from the current statutory scheme. The APA has long recognized that in appropriate circumstances an agency may issue rules without public notice and comment. Since its enactment in 1980, the RFA has only applied to

rules that are required to be issued for notice and comment because to do otherwise would interfere with the authority of an agency under the APA to issue non-notice regulations that respond to emergency situations or for other good cause. This amendment, particularly when coupled with the review panel provisions, will effectively prevent the IRS from quickly issuing regulations needed to curb tax abuses, to provide regulatory guidance to the public with respect to changes in the tax law made late in the year, or to address other needs for immediate regulatory guidance. We also note that the IRS would be the only agency whose temporary regulations would be subject to the requirements of the RFA.

### Conclusion

We strongly oppose the provisions of S. 1156 and urge that they be deleted from H.R. 3843. A refocused IRS is making organizational and other changes that will better identify and serve the needs of small businesses. S. 1156 would damage efficient tax administration by reducing the amount of helpful guidance issued to all taxpayers and would provide some small business interests with an inherently unfair advantage over their competitors as well as all other taxpayers. Finally, IRS rules that affect small businesses already are subject to added scrutiny which, when supplemented by organizational changes at the IRS, will help ensure that the concerns of small businesses are addressed without harming tax administration. Notwithstanding our strong opposition to S. 1156, we would be pleased to work with the Senate to identify other means to enhance participation by the small business community in the development of IRS rules.

The Office of Management and Budget has advised that there is no objection to the submission of this report.

Sincerely,

/s/  
Neal S. Wolin  
General Counsel

/s/  
Jonathan Talisman  
Deputy Assistant Secretary for Tax Policy

[Identical letter sent to the Honorable John F. Kerry]